VALUE OF THE SERVICE AS A FACTOR IN RATE MAKING*

"THE reasonableness of the schedule as a whole depends as has been seen, upon whether it yields a fair return to the carrier;"[1] yet "the requirement that no person may be charged more than a reasonable rate may be insisted upon although the result is that the company does not get a fair return from its schedule as a whole."[2] Rates may be so high as to be "unreasonable in themselves," although the company is "earning no more than a fair return";[3] yet "the rule that a carrier should not charge more than the traffic can bear . . . does not impose upon a carrier any duty to carry traffic at a loss."[4]

These antitheses are from one work on rate regulation. It contains more statements that the cost of a service outweighs its value in determining rates than statements that value outweighs cost;[5] at one point the author casts doubt, in terms, upon the value test which he repeatedly lays down;[6] in the preface he expresses his "preference for cost";[7] and he tells us that "more and more, the [Interstate Commerce] Commission has been laying

[1] BRUCE WYMAN, 2 ed., BEALE AND WYMAN, RAILROAD RATE REGULATION (1915), § 220.

[2] *Ibid.*, § 225.

[3] *Ibid.*, § 445.

[4] *Ibid.*, § 434.

[5] *Cf.* "It is certain upon fundamental principles that the company cannot justify exorbitant profits by urging that the rates are reasonable in themselves." *Ibid.*, § 226.

"Nothing is better established than that the Commission may not make the needs of the shipper the basis of reasonable rates." *Ibid.*, § 434.

"A railway may not impose an unreasonable rate merely because the business of the shipper is so profitable that he can pay it." *Ibid.*, § 439.

[6] The statement (*Ibid.*, § 435) that "the value of the service to the shipper should be considered, which includes a consideration of the profit that the shipper can make," carries this comment: "The correctness of this view may be doubted: at all events, the Commission has rejected any theory to the effect that rates may be increased by successive advances, so long as traffic moves freely. But, on the other hand, the Commission has said repeatedly that consideration must be given to the value of the service in determining reasonableness of rates."

[7] *Ibid.*, vi, vii.

* I am much indebted to the critical suggestions of my friend Professor Charles K. Burdick, who kindly read the manuscript and proof.

emphasis upon the cost of the service, as the element to be given precedence in the determining of a rate." [8] If the book conveys any net impression on the subject, it is that, while the criterion of cost is gaining ground as against the criterion of value, and should for some reason be preferred to it, value is none the less a criterion substantially coördinate with cost, and there is no knowing what will be done in a particular case when the two conflict.

Is value of the service, or reasonableness to the consumer, or reasonableness to the public — anything other than cost of the service (and discrimination) — a factor in public-service rate regulation? If so, in what relation does this factor, whatever it is, stand to the factor of cost? Commissions and courts have said things as inconclusive and contradictory as Mr. Wyman. The courts have long laid it down that a public utility is entitled to "a fair return upon the value of that which it employs for the public convenience"; [9] that is, rates are to be determined by the cost of the service, taking cost to include not only current out-go and depreciation but a reasonable return upon the value of the property employed. But a great deal is said about value of the service, reasonableness to the consumer, and the like, which, taken at its face, conflicts with this. Many *dicta* set up value as a criterion apparently coördinate with cost, and leave us to worry over the inevitable conflict. Thus the Interstate Commerce Commission said in 1912:

"Cost is generally an important element in arriving at a judgment with respect to a rate. What weight shall be given to that element as compared with all the other elements entering into a particular rate, such as the value of the service, with its bundle of constituents, and the various conditions surrounding the particular traffic, is a matter to be decided in each individual case. . . . Both cost and value must be considered as well as all other elements entering into a rate." [10]

The same opinion speaks of "the two cardinal principles of rate making — the cost of the service and the value of the service." Again in 1916 the commission said, "The law contemplates that

[8] BRUCE WYMAN, 2 ed., BEALE AND WYMAN, RAILROAD RATE REGULATION (1915), § 385. He adds: " . . . Certainly, the adequacy of the revenue for the service performed by the carriers must take precedence over market conditions in determining the reasonableness of a rate."

[9] Smyth *v.* Ames, 169 U. S. 466, 547 (1898).

[10] Per Meyer, Commr., in Boileau *v.* P. & L. E. R. R. Co., 22 I. C. C. 640, 652 (1912).

the rates shall be just and reasonable to shipper and carrier alike."[11] Language of the same sort has long been used by the Supreme Court of the United States. In *Smyth* v. *Ames*, Mr. Justice Harlan said:

"What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth." [12]

Speaking for the court in 1915, Mr. Justice Hughes said: "There are many factors to be considered, — differences in the articles transported, the care required, the risk assumed, the value of the service . . ." [13] Again in 1917 the Supreme Court repeated that "the nature and value of the service rendered by the company to the public are matters to be considered." [14]

Another group of *dicta* go further, and make of value of the service, or reasonableness to the public, a criterion not merely coördinate with, but superior to, cost of service. "Reasonableness relates to both the company and the customer. Rates must be reasonable to both, and, if they cannot be to both, they must be to the customer." [15] "The rates must be reasonable to the company, but they must, in any event, be reasonable to the public." [16] Mr. Robert H. Whitten, in an article on "Fair Value for Rate Purposes," uses closely similar language — "Reasonable compensation . . . must be just to the public and should be just to the company; but if it cannot be just to both it must in any event be just to the public." [17]

Logically, there are two halves to the proposition that cost must give way to value: rates must sometimes be fixed below cost, and they must sometimes be fixed above it. They must be fixed below cost when the value of the service to the public is less than

[11] New England Plaster, 41 I. C. C. 687, 704 (1916).

[12] 169 U. S. 466, 547 (1898).

[13] Northern Pacific Ry. Co. *v.* North Dakota, 236 U. S. 585, 599 (1915).

[14] Darnell *v.* Edwards, 244 U. S. 564, 570 (1917).

[15] Brunswick & T. Water Dist. *v.* Maine Water Co., 99 Me. 371, 380, 59 Atl. 537, 540 (1904).

[16] Southern Pacific Co. *v.* Bartine, 170 Fed. 725, 767 (1909).

[17] 27 HARV. L. REV. 421. *Cf.* Puget Sound Electric Railway *v.* R. R. Commission, 65 Wash. 75, 117 Pac. 739 (1911).

the service costs (whatever that may mean), and they must, similarly, be fixed above cost when the value of the service exceeds its cost. And even from the milder view that value is a rate-making factor coördinate with cost, it would follow that, in cases of conflict, rates must sometimes be fixed below, and sometimes above, the point of cost; for if, when two requirements conflict, one of them is always to yield to the other, the relation of the first to the second is not of equality but of subordination. To say that there can be no conflict between the two criteria, because that which is reasonable to the producer is always reasonable to the consumer also, is to abandon the proposition that reasonableness to the consumer counts. If value, or reasonableness to the consumer, means anything (*i. e.*, anything independent of cost, or reasonableness to the producer), by hypothesis it must, whatever it means, occasionally conflict with reasonableness to the producer. To say that cost is not conclusive, because value also must be given weight, but that value is always equal to cost, is evidently to insist upon two names for the same thing, to no other purpose than confusion.[18]

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[18] Yet there are advocates of a value-of-the-service standard who say that there is commonly complete identity between value of the service and cost of the service: between what is reasonable to the public and what is reasonable to the utility. Thus Mr. Robert H. Whitten, in the article just quoted, says: "Normally there is no conflict, for a rate that is just to the company is also just to the public. . . . For the normal successful public utility enterprise the reasonable rate of charge is the rate that affords the company a reasonable, and no more than reasonable, compensation for its entire service to the public." 27 HARV. L. REV. 421. So, a federal court has said: "Generally, that which is just, but no more than just, to the owner, ought to be the equivalent of that which is just, but no more than just, to the consumer." Spring Valley Water Co. *v.* City & County of San Francisco, 165 Fed. 667, 679 (1908). The Wisconsin Railroad Commission agrees: "Ordinarily the rate of return or the rates for services that are reasonable to the utility are also reasonable to the consumers." 4 Wis. R. R. Com. 625.

Both the Wisconsin Railroad Commission and Mr. Whitten speak of an exception to their rule of identity. The Commission refers to the case of "utilities which are operating under such conditions that no rates that can be collected from the consumers would be sufficient to meet" expenses, including a fair return. But this is no exception to the rule that cost alone governs, since, in this situation, rates are kept below the point of cost not by considerations of the value of the service but because it is (by hypothesis) impossible to collect cost: not by a rule of law but by a state of fact.

Mr. Whitten says: "It is for the most part only in cases where there has been poor judgment in the establishment of an enterprise, or changed conditions have rendered it inappropriate, that a rate which offers only a fair compensation to the company is

The questions then arise: Is it true that rates may sometimes be fixed by the state so low as not to cover the cost of the service (including a reasonable profit), although a rate which covers cost is possible? Is it true that they may sometimes be fixed by the utility so high that they more than cover the cost of the service including a reasonable profit? In dealing with these questions, we are not concerned, evidently, with the meaning of such phrases as value of the service, reasonableness to the consumer, and reasonableness to the public. If the answer to either question is yes, something other than cost must exist as a criterion superior to, or coördinate with, cost, and it will remain to inquire what that criterion is — whether value of the service (or reasonableness to the public) or something else. If the answer to both questions is no, no such superior or coördinate criterion exists.

It is assumed that the company is passably performing its duty to serve. If it is not, there is some suggestion that it should be encouraged to do so by denying it an adequate return in the meantime.[19]

Some cases which have been treated as holding that a rate need not cover cost are to be explained by the doctrine of the fair value of the property employed. "The basis of all calculations as to the reasonableness of rates to be charged . . . must be the fair value of the property." [20] Although the sense in which the courts use the phrase "fair value" is less definite than it should be,[21] it seems clear that the term does not cover money stupidly, extravagantly, or corruptly spent. If a utility has been seriously over-

unjust to the public." 27 HARV. L. REV. 421. This also is no true exception to the rule that cost alone governs: since, in this situation, rates either (1) are kept below the point of cost by a state of facts instead of a rule of law, or (2) are not kept below the point of cost (*i. e.*, reasonable return on the fair value of the property employed) at all, but only below the point of return on a higher, inflated value. The Northern Pacific case (note 55, *infra*) makes it clear that, if there is some rate which will bring in reasonable cost, a utility's right to charge that rate is qualified by no considerations of reasonableness to the public.

[19] *Re* Union Traction Co., P. U. R. 1918 B, 663 (Ind. Pub. Serv. Com.); Thorn *v.* Montgomery Light & Water Improvement Co., P. U. R. 1916 C, 406 (W. Va. Pub. Serv. Com.); *In re* Riverview Telephone Co., P. U. R. 1916 B, 442 (Wis. R. R. Com.).

[20] Smyth *v.* Ames, 169 U. S. 466, 546 (1898).

[21] *Cf.* Robert H. Whitten, "Fair Value for Rate Purposes," 27 HARV L. REV. 419; Robert L. Hale, "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," 18 COL. L. REV. 208.

built, or its promoters have been seriously overpaid, the law does not intend that its customers shall be saddled with the payment of interest on the money thrown away. In *San Diego Land and Town Co.* v. *National City*,[22] the Supreme Court held that the amount which a plant had actually cost its owners was not conclusive of the amount on which the public must pay a return — the fair value of the plant. The company having complained that the proposed rates would not permit a reasonable return on the cost of the plant, the court said:

"What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public. The property may have cost more than it ought to have cost, and its outstanding bonds for money borrowed and which went into the plant may be in excess of the real value of the property. So that it cannot be said that the amount of such bonds should in every case control the question of rates, although it may be an element in the inquiry as to what is, all the circumstances considered, just both to the company and to the public." [23]

San Diego Land and Town Co. v. *Jasper* [24] lays down the similar proposition that the "cost to another company which sold out on foreclosure to the appellant," when "seemingly inflated by improper charges . . . and by injudicious expenditures," is a different thing from the fair value of the property. In *Stanislaus County* v. *San Joaquin Canal Co.*,[25] it appeared that expensive mistakes had been made in organizing the company, and the Supreme Court took this into consideration in holding that a return need not be paid upon the cost of the property; that it was enough that a return was allowed upon its value. In the recent case of *Darnell* v. *Edwards*,[26] the court said by way of *dictum:* "The circumstance that a road may have been unwisely built, in a locality where

[22] 174 U. S. 739, 757, 758 (1899).

[23] The court observed that the cost-of-the-property basis was "defective in not requiring the real value of the property and the fair value in themselves of the services rendered to be taken into consideration." *Ibid.*, 757. But the reference to the value of the services, so far as it suggests that rates might on occasion be fixed at such a point that they would not pay a return on the fair value of the property, was pure *dictum*, as the court was engaged precisely in pointing out that, in the case before it, there was no evidence that a reasonable return on the fair value of the property would not be furnished by the rates complained of.

[24] 189 U. S. 439, 442 (1903).

[25] 192 U. S. 201, 214 (1904).

[26] 244 U. S. 564, 570 (1917).

there is not sufficient business to sustain it, may be taken into account."

This fair-value doctrine explains the Arkansas case of *Missouri Pacific Railway* v. *Smith*, which Mr. Wyman [27] relies on for the proposition that "a reasonable rate" (*i. e.*, evidently, a rate reasonable to the public), "may be insisted upon although the result is that the company does not get a fair return from its schedule as a whole." The case contains no suggestion that the company concerned was in danger of being deprived of a fair return from its schedule as a whole. The court simply held that the sum on which the company was entitled to a reasonable return was the fair value, and not an improperly inflated value, of its property. It held that the railroad's mere inability, under the legislative rates, to "pay the interest upon its just debts and the cost of maintaining and operating its railroad," was not fatal to the rates, because, for all that appeared, the debts might have been unreasonably and extravagantly contracted, and debts so contracted would not constitute value upon which the public could be required to pay a return.

"Rates of transportation sufficient to enable the road to realize a sum large enough to defray current repairs and expenses and pay a profit on the reasonable cost of building the road and equipping it ought to be reasonable. The earnings of a road might be sufficient for this purpose, and yet not large enough to pay expenses and interest on its debts." [28]

That a company cannot always claim a return on the value of property held for future use [29] is simply another illustration of the principle that the basis on which reasonable returns are calculated is the fair value of what the company is using for the public service, at the time when it is using it.

Clearly, cases holding that the fair value of the property employed is or may be something less than the property cost do not thereby hold that rates need not provide a reasonable return on

[27] BRUCE WYMAN, 2 ed., BEALE AND WYMAN, RAILROAD RATE REGULATION (1915), § 225.

[28] 60 Ark. 221, 242–44, 29 S. W. 752 (1895).

The case also involves the theory, now discredited, that a utility is not entitled to a reasonable return on every branch of its business, but only on its business as a whole.

[29] Capital City Gaslight Co. *v.* Des Moines, 72 Fed. 829, 845 (1896); Southern Pacific Co. *v.* Bartine, 170 Fed. 725 (1909).

the fair value of the property. To the particular element of extravagant construction it would be possible to give effect in either of two ways: by writing down the value of the property or by disallowing a reasonable rate of return. So far as this particular element is concerned, therefore, it may not greatly matter that what is actually done is to write down the value of the property. But in many connections the distinction between the two processes is important. Suppose all the elements which can be thought to affect the fair value of the property have been considered, and it has been determined that its fair value is *n*. If it were taken to be the law that rates need not provide a reasonable return, it would follow that a reasonable return on *n* need not necessarily be provided; while if the law requires a reasonable return on the fair value of the property employed in every case, then by hypothesis the company is entitled to a return on *n* regardless of all other considerations.

Unreasonable operating expenses, like unreasonable capital charges, are not part of what is meant by the cost of the service. The cost of the service as a rate-making criterion means its reasonable cost. The Supreme Court has said, in sustaining legislative railroad rates against the allegation (which was not fully established) that they did not cover operating expenses:

"Of what do these operating expenses consist? Are they made up partially of extravagant salaries; fifty to one hundred thousand dollars to the president, and in like proportion to subordinate officers? Surely, before the courts are called upon to adjudge an act of the legislature fixing . . . rates for railroad companies to be unconstitutional . . . they should be fully advised as to what is done with the receipts and earnings of the company; for if so advised, it might clearly appear that a prudent and honest management would, within the rates prescribed, secure to the bondholders their interest, and to the stockholders reasonable dividends. . . . It has not come to this, that the legislative power rests subservient to the discretion of any railroad corporation which may, by exorbitant and unreasonable salaries, or in some other improper way, transfer its earnings into what it is pleased to call 'operating expenses.'" [30]

This point — that utilities are not entitled to charge to the public, as a part of cost, the burden of their own extrav-

[30] Chicago & Grand Trunk Ry. Co. *v.* Wellman, 143 U. S. 339, 345, 346 (1892).

agance or inefficiency — has repeatedly been made by state commissions.[31]

One class of cases which seem or purport to lay down as a rule of law that rates need not always provide a reasonable return involve merely an encounter with the fact that rates cannot always produce such a return. An increase of rates will not always increase profits; if it would, there would presumably be no failures in business. It may and does occur that while a given rate will not produce a reasonable return, a higher rate, by cutting off custom, would produce a net return as small or even smaller. No rate, high or low, will earn some companies a fair return, for the simple reason that there is not a demand for their product in paying quantities and at a paying price. Where this condition exists, the enforcement of rates which produce an inadequate return involves no theory that the company is not entitled to an adequate return, whether because of a conflicting right in the public to a reasonable rate or for any other reason; it involves merely a recognition of the fact that to charge the consumer more in order that the company may earn less would benefit nobody. As the Wisconsin Railroad Commission has said: "If the rates are placed at too high a figure, consumption will fall off and the gain from the high rate charges" is "likely to be more than offset by losses in the number of takers." [32] In another case the Wisconsin commission was obliged to fix rates at an unremunerative point for the reason that there was no remunerative point. Because of the ease with which water could be got in its locality, the business of a water company was competitive, and customers simply would not pay a rate high enough to give the company a profit. The commission said:

"The fact that consumers will not pay a rate which will enable the utility to earn what would ordinarily constitute a reasonable rate of return upon its property, may not affect the justice of such a charge or the legal right of the utility to charge such rates, but the fact that the utility has a legal right to a reasonable return upon its property will

[31] *Re* Atlantic County Electric Co., P. U. R. 1918 B, 589, 591 (N. J. Board of Pub. Util. Commrs.); *Re* Charles Town Water Co., P. U. R. 1916 D, 725, 733 (W. Va. Pub. Serv. Com.). *Cf.* Salisbury *v.* Salisbury Lt., Ht. & Pwr. Co., P. U. R. 1918 E, 331, 335 (Md. Pub. Serv. Com.); San Diego Water Co. *v.* San Diego, 118 Cal. 556, 572, 50 Pac. 633 (1897), and note, 52 L. R. A. (N. S.) 51.

[32] *In re* Manitowoc Gas Co., 3 Wis. R. R. Com. 163, 177 (1908).

not prove of much value if it loses a large part of its business because of the presence of competition or the inability of consumers to pay enough to ensure the company such a return." [33]

A case before the Colorado Public Utilities Commission in 1916 illustrates the same point. The commission declined to permit as large an increase in gas rates as the company asked for, although it expressly found that, at the rates which were adopted, the company would "not earn a fair rate of return on the present fair value of the gas properties." [34] The commission made use of the argument that the schedule the company proposed would "result in rates and charges exceeding the value of the service rendered"; [35] but no such argument was necessary or pertinent. For the commission anticipated that, at the rates it prescribed, the company's income would increase, while it found that

"in the event permission should be given . . . to make a schedule of rates and charges which would" (theoretically) "bring about a fair rate of return upon the present fair value of the gas properties, such schedule would result in a charge exceeding the value of the service rendered *and would result in decreased revenues through consequent loss of patronage.*" [36]

A case decided in 1916 in the United States District Court for the district of Nevada involved a similar situation. At the rates which a water company was charging, many consumers bought their water from wagons instead of patronizing the company. The court sustained a reduction of rates, although the company did not appear to be making a large return. It cited some of the *dicta* to the effect that rates must not exceed the value of the service, and undoubtedly relied partly on the idea that the water was not worth what was being charged for it. But nothing turned on that theory; for the court did not anticipate that the reduction in rates would reduce the company's earnings. It said, "the pre-

[33] *In re* Oconto City Water Supply Co., 7 Wis. R. R. Com. 497, 556, 557 (1911).

Mr. Robert L. Hale, in an article on "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," 18 COL. L. REV. 208, 210, cites these Wisconsin cases and observes: "The 'value of the services' concept was not needed to justify the commission in the situation described, as it must be quite clear that the company is deprived of nothing at all when its rates are kept down to the point where they yield the utmost net earnings commercially possible."

[34] *Re* Colorado Springs Light, Heat, & Power Co., P. U. R. 1916 E, 650, 658.

[35] *Ibid.*, 657.

[36] *Ibid.*, 659.

vailing rates exceed the reasonable worth of the services rendered *and unduly discourage consumption of water.*" "Lower rates should at least be fairly tested." [37] In each of these cases the tribunal treated with respect, and believed that it applied, the theory that rates must not exceed the value of the service, but in neither was that theory at all necessary to the result.

There remain an abundance of *dicta* that rates may sometimes be fixed below cost. These examples from the United States Supreme Court are much quoted:

"We do not wish to be understood as laying down as an absolute rule, that in every case a failure to produce some profit to those who have invested their money in the building of a road is conclusive that the tariff is unjust and unreasonable. . . . There may be circumstances which would justify such a tariff." [38] "The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends." [39] "It would not . . . be claimed that the railroads could in all cases be allowed to charge grossly exorbitant rates as compared with rates paid upon other roads in order to pay dividends to stockholders. . . . The rule stated in *Smyth* v. *Ames* . . . that the railways are entitled to a fair return upon the capital invested . . . might not justify them in charging an exorbitant mileage in order to pay operating expenses, if the conditions of the country did not permit it." [40]

These sayings are all frankly *dicta*. In *San Diego Land and Town Co.* v. *National City*,[41] the court in sustaining rates of which the company complained spoke of the original-cost basis for computing proper returns as "defective in not requiring the real value of the property and the fair value in themselves of the services rendered to be taken into consideration"; but, as there is nothing in the case to suggest that the rates of which the court approved would yield less than a reasonable return on the fair value of the property, the intimation that rates must in any event be kept down to the "fair value in themselves of the services rendered" is another *dictum*.

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[37] Goldfield Consolidated Water Co. *v.* Pub. Serv. Com. of Nevada, 236 Fed. 979, 986 (1916).

[38] Reagan *v.* Farmers Loan & Trust Co., 154 U. S. 362, 412 (1894).

[39] Covington & Lexington Turnpike Co. *v.* Sandford, 164 U. S. 578, 596 (1896).

[40] Minneapolis & St. Louis Railroad Co. *v.* Minnesota, 186 U. S. 257, 268 (1902).

[41] 174 U. S. 739, 757 (1899).

Cary v. *Eureka Springs Railway Co.*,[42] decided by the Interstate Commerce Commission in 1897, is relied on by Mr. Wyman [43] for the proposition that rates may be so high as to be "unreasonable in themselves," although the company is "earning no more than a fair return." In that case two roads were involved. The Eureka Springs Railway Company had for many years earned an average profit far in excess of six per cent on its investment, besides accumulating a large surplus. Its earnings during the two years preceding the suit did not exceed six per cent; but the commission considered that the falling off in those years (1895 and 1896) could "only be deemed casual and temporary," as it was due to "temporary financial contingencies arising from exceptional causes," and that the "additional earnings" of previous years were "amply sufficient" to meet such contingencies. The commission further found that the "decrease in the earnings . . . was largely in the passenger traffic" (the rates charged for which the commission did not reduce), and that "more moderate rates will hardly fail to induce travel and increase the volume of freight as well as passenger business." In other words, it was found not merely that the existing freight rates — which the commission lowered — were high as compared with rates elsewhere, but also that, taking one year with another, the existing rates were giving the company an excessive return, and that the prescribed reduction would not reduce the company's returns below a reasonable point. The rates were also found to be discriminatory as between localities, and this was an additional ground for lowering them. Of the other railroad involved, the commission said:

"Nor is there anything in the facts ascertained, to justify the belief that under ordinary industrial conditions, the net earnings of this company are not, and with the moderate reduction proposed will not be, sufficiently and amply remunerative."

The case, then, fixed no rates which were not expected to produce a reasonable return on the value of the property involved. It therefore completely fails to support the theory that unremunerative rates may be fixed in order that the value of the service may not be exceeded.

[42] 7 I. C. C. 286, 316–18 (1897).

[43] BRUCE WYMAN, 2 ed., BEALE AND WYMAN, RAILROAD RATE REGULATION, § 445.

In 1916 the California Railroad Commission, in allowing a water company a much smaller increase in water rates than it asked for, declared that it applied

"the well-established rule in public utility regulation, that while rates must be reasonable to the utility, they must, in any event, be reasonable to the public. The cases clearly establish the principle that the rates charged by a public utility must in no event be higher than the service is reasonably worth to the consumer." [44]

But it is doubtful whether the case actually allowed the company less than a reasonable return. For the rates prescribed were expected to yield a net return, which, though small, may have amounted to 4.25 [45] per cent on the value of the property, even including a considerable amount of property which was not used or useful; and a comparatively small return would be reasonable in view of the fact that consumers had bought their land from a company closely affiliated with the petitioner, and their water rights from the petitioner as part of the same transaction.

The *obiter* character of what is said in the Oklahoma case of *Oklahoma Gin Co.* v. *State*,[46] seems quite as clear. A commission's order fixing the rate for cotton ginning in a city at fifty cents per bale was sustained, in spite of the commission's admission that "the price of fifty cents per bale is not sufficient to pay the operating expenses and keep all the gins . . . in operation during the ginning season." The Oklahoma court declared that it was quite immaterial whether the gins did business at a loss or not; in other words, it adopted an extreme value-of-the-service standpoint. But it had no need, in order to sustain the commission's order, to adopt anything of the sort, or to ignore the requirement of a reasonable return to the producer; for it had not been admitted or shown that there were no gins, or an insufficient number of gins to handle the business, which could make a profit at the fifty-cent rate; or that, if the number of gins were reduced to correspond with the needs of the community, that rate would not give a profit to all.

[44] *Re* Lake Hemet Water Co., P. U. R. 1917 A, 458, 483.

[45] It may also have amounted to less. This figure is obtained by selecting from the various alternative estimates which the case contains, of cost, depreciation, operating expenses, etc., those least favorable to the company's demand; the commission itself makes no selection.

[46] (Okla.), 158 Pac. 629 (1916), P. U. R. 1916 C, 22.

One case, decided in 1888 by the Interstate Commerce Commission,[47] may have fixed rates too low to produce a reasonable return to the carrier; but this is not clear. The earnings of the New Orleans and North Eastern, while they were "above operating expenses," were not and never had been "sufficient for the payment of operating expenses and interest or fixed charges"; yet the commission found, on grounds of reasonableness to the public, that a rate of this road should be lowered to one less excessive as compared with other ton-mile rates in the same region. But "interest or fixed charges" do not necessarily coincide with a return on the value of the road, and a return on that value may possibly have been earned both before and after the reduction.

The law, in any case, is clear enough. In *Atlantic Coast Line* v. *North Carolina Corporation Commission*,[48] the United States Supreme Court said by way of *dictum:*

"In a case involving the validity of an order enforcing a scheme of maximum rates of course the finding that the enforcement of such scheme will not produce an adequate return for the operation of the railroad, in and of itself demonstrates the unreasonableness of the order."

In other words, all the talk of courts — including the Supreme Court itself — commissions and text-writers to the effect that rates may be fixed so low that they will not produce a reasonable return to the company, if that is necessary in order that they may not exceed the value of the service to the public, is baseless. The law to-day is clearly in accordance with this *dictum.*

The doctrine that the producer is always entitled to a reasonable return, whatever the needs of the consumer or the value of the service to him may be, has several times been applied by the Interstate Commerce Commission. *Re Alleged Excessive Freight Rates and Charges on Food Products*[49] was the commission's report to the Senate on an investigation made at its direction. The commission refused to find certain rates unreasonable, although people were unable, at those rates, to market food products which they had long been accustomed to market.

[47] New Orleans Cotton Exchange *v.* Cincinnati, New Orleans, & T. P. Ry., 2 I. C. C. 375 (1888).

[48] 206 U. S. 1, 24, 25 (1906).

[49] 4 I. C. C. 48, 66, 67.

"There is an excellent clay in Nebraska for making bricks, a useful and creditable industry. Bricks are much needed in New York. The people of Nebraska have a right to make them as well as a right to have them shipped to New York at reasonable rates. But it might be that when such reasonable rates were deducted from the price received the remainder would be less than the 'actual cost of production.' That would not necessarily make the rates unreasonable. Unfortunate it may be, but still, of necessity, the claims of the shipper must wait upon the rights of those whose services he employs and whose property he uses. The employees who run the train may have neither brick, corn, nor railroad investment, but they must be paid for their services. The road must be repaired and bridges mended. Actual and honest investment must receive fair reward. All this must be paid before the profits or actual cost of producers are paid unless the services and property of others are to be appropriated to the use of those who for the time may be engaged in an unprofitable business or disadvantageously located industry."

Similarly, the commission in 1910 refused to lower rates on pineapples to or near a point at which producers could market them profitably.

"The position of the growers is that such rates should be established as will permit them to market their product at a reasonable profit. No such test of the justness of a transportation charge can be admitted."[50]

The point that the utility must always be allowed a reasonable return, regardless of the value of the service, is not fully established by *Reagan* v. *Farmers' Loan and Trust Co.*[51] and *Covington and Lexington Turnpike Co.* v. *Sandford*,[52] which held that rates which produced no return on the investment were invalid; for both these cases intimated that the right to some return was not absolute, and would or might in some cases have to give way to the right of the public to pay no more than a reasonable price. But the matter is concluded by *Northern Pacific Railway* v. *North Dakota*,[53] decided by the Supreme Court in 1915.

It would be possible, evidently, to admit the necessity of a

[50] Florida Fruit & Vegetable Shippers' Assn. *v.* A. C. L. R. R., 17 I. C. C. 552, 560 (1910).

Cf. In re San Diego & Southeastern Ry. Co., P. U. R. 1916 C, 1 (Cal. R. R. Com.). The commission refused to lower rates, in spite of the allegations of shippers that they could make no profit under existing rates.

[51] 154 U. S. 362 (1894).

[52] 164 U. S. 578 (1896).

[53] 236 U. S. 585 (1915).

reasonable return on the entire business of a public utility and yet to deny the necessity of such a return on each kind of service which it performed. But it is not possible to admit the necessity in the case of each particular service and deny it in the case of the business as a whole. If a company is to make a profit on each service it performs, it must inevitably make a profit on its entire business; if, therefore, it is entitled to make a profit on each service, regardless of the value of the service and the needs of the consumer, it follows that it is entitled, equally regardless, to make a profit on its whole business.

Is a utility entitled to make a profit on each service? In the Arkansas case of *Missouri Pacific Railway Co.* v. *Smith*,[54] it was held that a railroad might be required to carry passengers at a loss, so long as it was allowed to earn a profit on its aggregate business, passenger and freight. The Northern Pacific case [55] in the Supreme Court settled the law to the contrary. It decided that rates on a particular commodity (coal) which did not yield a return large enough to cover the overhead charges attributable to coal could not be enforced, regardless of whether the company was earning a fair return on its whole business, and regardless also of the effect which increased rates would have upon the public.

"Where it is established that a commodity, or a class of traffic, has been segregated and a rate imposed which would compel the carrier to transport it for less than the proper cost of transportation, or virtually at cost, and thus the carrier would be denied a reasonable reward for its service after taking into account the entire traffic to which the rate applies, it must be concluded that the State has exceeded its authority." "As a carrier for hire, it cannot be required to carry persons or goods gratuitously. The case would not be altered by the assertion that the public interest demanded such carriage. . . . It would be no answer to say that the carrier obtains from its entire intrastate business a return as to the sufficiency of which in the aggregate it is not entitled to complain. . . . It is urged by the State that the commodity in question is one of the lowest classes of freight. This may be assumed, and it may be a good reason for a lower rate than that charged for carrying articles of a different sort, but the mere grade of a commodity cannot be regarded as furnishing a sufficient ground for compelling the carrier to transport it for less than cost or without substantial reward.

[54] 60 Ark. 221, 244, 29 S. W. 752 (1895).

[55] 236 U. S. 585, 595–98, 604 (1915).

"The State insists that the enactment of the statute may be justified as 'a declaration of public policy.' In substance, the argument is that the rate was imposed to aid in the development of a local industry and thus to confer a benefit upon the people of the State. The importance to the community of its deposits of lignite coal, the infancy of the industry, and the advantages to be gained by increasing the consumption of this coal and making the community less dependent upon fuel supplies imported into the State, are emphasized. But, while local interests serve as a motive for enforcing reasonable rates, it would be a very different matter to say that the State may compel the carrier to maintain a rate upon a particular commodity that is less than reasonable, or — as might equally well be asserted — to carry gratuitously, in order to build up a local enterprise."

In the next case in the same volume,[56] the Supreme Court applied to passenger rates the principle that it had just applied to rates on coal; *i. e.*, it held that passenger rates must yield the company a profit, irrespective of the profitableness of the company's entire business.

"It would not be contended that the State might require passengers to be carried for nothing, or that it could justify such action by placing upon the shippers of goods the burden of excessive charges in order to supply an adequate return for the carrier's entire service. And, on the same principle, it would also appear to be outside the field of reasonable adjustment that the State should demand the carriage of passengers at a rate so low that it would not defray the cost of their transportation, when the entire traffic under the rate was considered, or would provide only a nominal reward in addition to cost." [57]

The rule, which these cases so clearly establish, that each service must pay its own costs, should be understood in this sense:

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[56] Norfolk & Western Ry. Co. *v.* Conley, 236 U. S. 605, 609 (1915).

[57] In each of these cases the Supreme Court added a curious *caveat.* In the Northern Pacific case it said: "If in such a case there exists any practice, or what may be taken to be (broadly speaking) a standard of rates with respect to that traffic, in the light of which it is insisted that the rate should still be regarded as reasonable, that should be made to appear." 236 U. S. 585, 599 (1915). In the Norfolk and Western case it said: "If in any case it could be said that there existed other criteria by reference to which the rate could still be supported as a reasonable one for the transportation in question, it would be necessary to cause this to appear." 236 U. S. 605, 609 (1915). But the court does not appear to have had in mind any "practice," "standard," or "criteria" by reference to which it might be proper, on occasion, to violate the requirement of a reasonable return, and the implied *dicta* that such conditions might conceivably be discovered detract little from the force of the decisions.

that each service *which can conveniently be treated as distinct* must pay its own costs. Almost any service which is treated for rate-making purposes as a single division of a utility company's business might conceivably be subdivided into different services differing more or less in the cost of performing them. For example, it costs more to carry a passenger who weighs 180 pounds than one who weighs 130 pounds, yet both pay the same fare. In the interest of simplicity and practicability, the subdivision of services must, as it does, stop somewhere; and its stopping somewhere hardly derogates from the principle that each service must pay its own costs. This would seem to be the true explanation of the cases in which the Supreme Court has held that carriage over a section of road where costs are high, because of expensive construction[58] or light traffic,[59] entitles the carrier to no extra compensation, but only to the normal rate which when applied to its whole road gives a fair return. It seems also measurably to reconcile the case of *Atlantic Coast Line* v. *North Carolina Corporation Commission*,[60] in which the court held that a railroad might be compelled to operate a particular connecting train on which it lost money.

Since a utility company is entitled wherever possible, and re-

[58] St. Louis & San Francisco Ry. Co. *v.* Gill, 156 U. S. 649, 665 (1895).

[59] Puget Sound Traction Co. *v.* Reynolds, 244 U. S. 574 (1917).

Cf. State *ex rel.* Missouri Pacific Ry. Co. *v.* Atkinson, 269 Mo. 634, 192 S. W. 86 (1917).

[60] 206 U. S. 1 (1907). The Supreme Court (White, J.) in this case adopts, and in Northern Pacific Railway *v.* North Dakota, 236 U. S. 585 (1915), repeats a distinction which is far from convincing; *viz.*, that to run a train is "to furnish a facility which it is a part of" the railroad's "general duty to furnish for the public convenience. The distinction between an order relating to such a subject and an order fixing rates" is that "as the primal duty of a carrier is to furnish adequate facilities to the public, that duty may well be compelled, although by doing so as an incident some pecuniary loss from rendering such service may result." 206 U. S. 26.

Doubtless one primal duty of a carrier is to furnish adequate facilities to the public; but the duty of actually carrying passengers and commodities would seem to be quite as primal as the duty of furnishing adequate facilities for their carriage. If a road may be compelled to furnish means at a loss, why may it not be compelled to permit their use at a loss? Of course the court would not require a road to furnish passenger facilities in general at a loss; in Norfolk & Western Railway Co. *v.* Conley, 236 U. S. 605 (1915), it held, what comes to the same thing, that a road could not be compelled to carry at a loss its passenger traffic as a whole. But the carriage of passengers on the less patronized and on the more patronized trains may well be lumped together and treated as a single service.

Cf. Jones *v.* K. C., C. C., etc. Ry. Co., P. U. R. 1918 D, 586 (Mo. Pub. Serv. Com.).

gardless of all other considerations, to charge for every service it performs what that service costs, it is clear that there is no criterion, whether of the value of the service or anything else, which can compete with the criterion of cost as against the company. The proposition is a constitutional one. Both the Northern Pacific case and its fellow [61] involved state action, which the United States Supreme Court (in 1915) held unconstitutional, and the cases of course establish the law for every tribunal in the country. Yet the old idea that a utility's right to charge what its service costs is conditioned on the service being worth so much is currently set forth as a truism in the *dicta* of commissions.[62]

The constitutional proposition of the Northern Pacific case disposes at the same time of a common-law question which might otherwise arise. Public utilities (if not all businesses) have a common-law duty to serve at reasonable rates. Whether the discharge of this duty might sometimes involve their serving at less than cost, might be a fair common-law question, were it not foreclosed by the Supreme Court's determination that service at less than cost cannot constitutionally be required of them.

Rates may never be fixed, by the state, below the cost of the service. May they sometimes be fixed, by the utility, above the cost of the service? Is there some criterion, whether of value of the service or something else, which can compete with cost in favor of the company? This also involves a common-law and a constitutional question: the common-law question whether a utility sometimes may, consistently with its duty of serving at reasonable rates, charge rates which exceed cost, and the constitutional question whether the state may, consistently with due process of law and other constitutional restrictions, reduce to cost all rates which exceed it.[63] If there be a rule of constitutional law

[61] Notes 55 and 56, *supra*.

[62] *E. g.*, *Re* Heisen, P. U. R. 1917 B, 644 (Ill. Pub. Util. Com.); *Re* Colorado Springs Lt. Ht. & Pwr. Co., P. U. R. 1916 C, 464, 482 (Colo. Pub. Util. Com.); Salisbury *v.* Salisbury Lt. Ht. & Pwr. Co., P. U. R. 1918 E, 331, 334 (Maryland Pub. Serv. Com.); *Re* New Jersey Gas Co., P. U. R. 1918 B, 438, 441 (N. J. Board of Pub. Util. Commrs.); *Re* Portland Railway Lt. & Pwr. Co., P. U. R. 1918 B, 266, 274 (Pub. Serv. Com. of Ore.).

[63] Conceivably the charging of rates which exceed cost involves another constitutional question. It has been suggested that the consumer is unconstitutionally deprived of his property if the utility is permitted to charge more than a reasonable rate; So. Ind. Ry. Co. *v.* R. R. Com., 172 Ind. 113, 87 N. E. 966 (1909); Civic League of St. Louis *v.* St. Louis Water Dept., P. U. R. 1917 B, 576 (Missouri Pub. Serv. Com.);

that, under some circumstances, the state may not reduce rates to cost, this is to say that utilities are at liberty under those circumstances to fix rates above cost; and again there is an end of the common-law question. But if, on the other hand, the rule of constitutional law be that the state may reduce rates to cost under all circumstances, what follows is simply that utilities may not effectively fix them higher if the state objects. There is no compulsion on the state to object, and whether it does so is for its courts, subject to free correction by its legislature, to determine. The common-law question, in other words, is in this case an independent one. And it is in this second direction that the constitutional question is decided.

It was pointed out above that the valuation of public-service property on another basis than that of cost must result, when the valuation is less than the cost, in the fixing of rates which, while they yield a reasonable return on the fair value of the property, do not yield such a return on its cost. This is a matter of valuation, of the basis on which returns are computed, with which this discussion of rates of return has nothing directly to do. In just the same way, it has nothing directly to do with the valuation of property above its original cost. The Supreme Court is probably prepared to value property above its original cost in some cases.[64] It would follow that rates, to be constitutional, must in such cases be high enough to produce a reasonable return on something more than cost; in other words, to produce more than a reasonable return on cost. It does not follow that rates must ever be high enough to produce more than a reasonable return on fair value. And if a rate produces no more than a reasonable return on the fair value of the property employed, by hypothesis it does not exceed the cost of the service; since the cost of the service, by definition, includes a reasonable return on the fair value of the property.

Similarly, there is some suggestion that the cost of operation of a particularly efficient and economical company should be reckoned at something more than its actual current expenditures; in

contra, Brooklyn Union Gas Co. *v.* New York, 50 N. Y. Misc. 450, 100 N. Y. Supp. 570 (1906), pointing out that the law does not require the consumer to take the service.

[64] *Cf.* Willcox *v.* Consolidated Gas Co., 212 U. S. 19, 52 (1902); Minnesota Rate Cases, 230 U. S. 352, 454 (1913); San Joaquin Co. *v.* Stanislaus County, 233 U. S. 454 (1914); Robert L. Hale, "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," 18 COL. L. REV. 208.

order that the company may profit somewhat from its efficiency and economy.[65] This is a matter of defining cost, or reasonable cost; not of permitting rates to exceed cost.

A United States Circuit Court has delivered a *dictum* to the effect that the state may not constitutionally reduce rates to the cost of the service when the existing rates are no greater than the service is "worth." [66] This *dictum* is perhaps unique. The Supreme Court case of *Cotting* v. *Kansas City Stock Yards Co.*[67] has been thought to hold that rates may not constitutionally be forced down to the point where they yield only a reasonable return to the company, if some higher rate is reasonable to the consumer. The case has some appearance of laying down such a rule, chiefly because the only elaborate opinion it contains takes that view. But this opinion, while it reaches the result which the court reached, was concurred in by only a minority. No such view is involved either in the opinion of the majority or in the decision of the court. The Kansas legislature had passed an act which classified as "public stock yards" all yards which handled a certain amount of live stock per day. Various regulations were imposed upon "public stock yards"; among other things, the rates which they might charge were fixed and lowered. The Kansas City Stock Yards Company was the only concern the business of which was large enough to bring it within the act. The Supreme Court enjoined the enforcement of the statute, but not at all on the ground that it would be unconstitutional to limit profits to a reasonable return on the fair value of the property employed. The majority — six judges — rested the unconstitutionality of the statute solely on the ground that it deprived the company of the equal protection of the laws. That is, they decided nothing more than that mere volume of business — the basis of classification in the act — was not a reasonable basis of classification; that a company might not legally be selected for subjection to regulation of various sorts, while all others were left unregulated, on the sole ground that its volume of business was large. It was not decided that large profits, as distinguished from a large volume of business, would be an improper basis of

[65] L. R. A. 1915 A, 43, note, and cases cited.

[66] Central of Georgia Railway *v.* R. R. Commission (Ala.) 161 Fed. 925, 994 (1908).

[67] 183 U. S. 79 (1901).

classification, though the long minority opinion of Mr. Justice Brewer contains abundant *dicta* to that effect. The court had no opportunity, if it had the inclination, to decide such a thing, and the majority did not intimate that it had any such inclination.

On the other hand, two decisions of the United States Supreme Court involve, though they do not express, both the constitutional proposition that the state may reduce to cost rates which exceed it, even if the value of the service be higher, and the common-law proposition that rates which exceed cost are unreasonable and should be reduced, even if the value of the service be higher. In *Central Yellow Pine Association* v. *Illinois Central Railroad*,[68] and *Tift* v. *Southern Railway*,[69] the Interstate Commerce Commission held that the increased prosperity of the lumber business did not justify increases in rates which were already remunerative, and ordered the carriers to reduce their rates. In the Tift case, the commission said:

"It is clear that, if a rate on an article of traffic is already renumerative, the increased prosperity of the business of manufacturing that article is no ground for an advance of the rate. The claim to the contrary on the part of the carriers is based upon the erroneous assumption, so prevalent among traffic managers, that a rate may be made as high as 'the traffic will bear' . . . 'The test of the reasonableness of a rate is not the amount of the profit in the business of a shipper or manufacturer, but whether the rate yields a reasonable compensation for the services rendered. If the prosperity of the manufacturer is to have a controlling influence, this would justify a higher rate on the traffic of the prosperous manufacturer than on that of one less prosperous. The right to participate in the prosperity of a shipper by *raising rates* is simply a license to the carrier to appropriate that prosperity, or in other words, to transfer the shipper's legitimate profit in his business from the shipper to the carrier.'" [70]

Both of these cases were followed by proceedings in the United States courts, and ultimately in the Supreme Court, in which the commission's orders were sustained and the roads were required to obey them. In the Tift case,[71] the Circuit Court pointed out that the antecedent rates were conceded to be remunerative, and that the roads were prosperous, and declared that the roads had

[68] 10 I. C. C. 505 (1905).
[69] *Ibid.*, 548.
[70] *Ibid.*, 548, 582.
[71] Tift *v.* Southern Railway, 138 Fed. 753, 763 (1905).

no "right, by arbitrarily increasing freight rates, to divert at any time to their own treasuries a share of the profits of successful industries or occupations." The Supreme Court [72] did not discuss or formulate the rules that, even when the consumer is particularly prosperous and the service particularly advantageous to him, rates may not reasonably be fixed by the utility above the cost of the service, and that, if so fixed, they may constitutionally be reduced to cost by the state. No attack on the commission's action on constitutional grounds seems to have been made. But both rules are involved in the court's action in sustaining the commission's rates and affirming the decrees against the companies. For the commission and the lower courts had acted on both rules, and an opposite rule on either point would have led to an opposite conclusion and a reversal. It must be supposed that, if the Constitution were violated by forcing rates down to the cost of the service regardless of its value, the Supreme Court would have taken judicial notice of the fact and refrained from doing so. In the Illinois Central case, it said:

"The question submitted to the Commission . . . was one which turned on matters of fact. In that question, of course, there were elements of law, but we cannot see that any one of these or any circumstance probative of the conclusion was overlooked or disregarded." [73]

These decisions are reënforced by the analogy of the rule, which the Supreme Court has not only applied but plainly expressed that rates may not be fixed below cost by the state: [74] and there is nothing from that court to set against them except broad *dicta* to the general effect that value is as important as cost. There is, in fact, little disposition in any quarter to give the general proposition that value of service is as important as cost any specific application to the situation in which value is thought to exceed cost. It is hardly disputed (otherwise than by the assertion of the general proposition in question) that rates which exceed cost constitutionally may, and legally should, be reduced to cost, whatever the value of the service. Every American decision or statement

[72] Illinois Central Railroad *v.* Interstate Commerce Commission, 206 U. S. 441 (1907); Southern Railway *v.* Tift, 206 U. S. 428 (1907).

[73] Illinois Central Railroad *v.* Interstate Commerce Commission, 206 U. S. 441, 466 (1907).

[74] Notes 55 and 56, *supra*.

that they should is of course in effect, however implicitly and unconsciously, an expression of the tribunal's opinion that they may. There are an abundance of *dicta* [75] and decisions [76] that rates must not exceed cost (including a fair return), in which nothing is said of value. This is of course tacitly to treat value as immaterial when cost is known. In *Stanislaus County* v. *San Joaquin Canal Co.*,[77] for example, the Supreme Court, without discussing the value of the service, sustained a reduction in rates on the basis of the profits the company was making, and said:

"It is not confiscation nor a taking of property without due process of law, nor a denial of the equal protection of the laws, to fix water rates so as to give an income of six per cent upon the then value of the property actually used . . . even though the company had prior thereto been allowed to fix rates that would secure to it one and a half per cent a month income upon the capital actually invested in the undertaking. If not hampered by an unalterable contract . . . a law which reduces the compensation theretofore allowed to six per cent upon the present value of the property used for the public is not unconstitutional. There is nothing in the nature of confiscation about it."

There are also some decisions (besides those already discussed) confining rates to cost, in which the contention that the value of the service concerned exceeds its cost is expressly dealt with and declared to be irrelevant. In *Oregon & Washington Lumber Manufacturers' Association* v. *Union Pacific Railroad*,[78] in disapproving certain advances in rates on lumber, the Interstate Commerce Commission said: "If the old rates were just and reasonable, the defendants cannot justify the advance on the ground of the prosperity of the lumber business. . . ." And in *Commercial Club of*

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[75] Turner *v.* Connecticut Co., 91 Conn. 692, 101 Atl. 88 (1917); Hartford *v.* Connecticut Co., P. U. R. 1918 C, 611, 627; (Conn. Pub. Util. Com.); Salisbury *v.* Salisbury Lt., Ht. & Pwr. Co., P. U. R. 1918 E, 331 (Md. Pub. Serv. Com.); *Re* Farmers and Merchants Telephone Co., P. U. R. 1918 F, 283, 289 (Neb. Ry. Com.); *Re* Bronx Gas and Electric Co., P. U. R. 1918 D, 300, 329 (N. Y. Pub. Serv. Com., First Dist.).

[76] Stanislaus County *v.* San Joaquin Canal Co., 192 U. S. 201, 213 (1904); Cedar Rapids Water Co. *v.* Cedar Rapids, 118 Iowa 234, 91 N. W. 1081 (1902); Home Telephone Co. *v.* Carthage, 235 Mo. 644, 139 S. W. 547 (1911); Garwood *v.* Colo. Southern Ry. Co., P. U. R. 1916 A, 911 (Colo. Dist. Ct., Div. 2); *In re* Colo. Springs Lt., Ht. & Pwr. Co., P. U. R. 1916 A, 872, 887 (Colo. Pub. Util. Com.). The Railroad Passenger Rate Case, P. U. R. 1915 B, 362, 368, 369 (Mass. Pub. Serv. Com.; perhaps *dictum*).

[77] 192 U. S. 201, 213 (1904).

[78] 14 I. C. C. 1, 15 (1908).

Omaha v. *Anderson & Saline River Railway Co.*,[79] in holding another lumber rate too high, the commission said:

"Defendants contend that the rate of 26½ cents to Omaha is shown to be reasonable by the facts that the traffic moves freely and that the lumber business in Omaha has greatly increased. . . . We are not, as at present advised, ready to accept the theory that rates may lawfully and reasonably be increased by progressive advances as long as the traffic moves freely. . . . Some traffic must move, and reasonably freely, up to the point where the rate becomes prohibitive."

A logical modern case, decided by the Supreme Court of Wisconsin, is *Duluth Street Railway Co.* v. *Railroad Commission of Wisconsin*.[80] The commission had reduced street-car fares, on the ground that the existing ones yielded the company a net return of 7½ per cent on the fair value of its property. The court sustained the action of the commission, against the company's contention that the reasonableness of rates depended not upon the company's profit but upon what the service was "worth to the public." The court observed that the value of a service rendered by a monopoly is a vague idea, and continued:

"The cost of the service is the most definite and tangible guide there is to tie to in making rates, if, indeed, it is not the only one. Where rates are so adjusted as to yield a fair return on the value of the property over and above expenses and depreciation, they are reasonable. Where they are so fixed as to materially exceed this sum, they are not."

The House of Lords,[81] and in one case, curiously enough, the Interstate Commerce Commission,[82] seem to have taken the

[79] 18 I. C. C. 532, 536 (1910).

[80] 161 Wis. 245, 152 N. W. 887 (1915); P. U. R. 1915 D, 192.

[81] Canada Southern Railway *v.* International Bridge Co., 8 A. C. 723 (1883); contains at least a vigorous *dictum* to the effect that the value of the service to the consumer is practically the only thing that counts in determining how much he may reasonably be charged; that the producer's profit, unless it is "enormously disproportionate to the money laid out," has nothing to do with it. Of course no constitutional question was involved in the case. Moreover, it is not at all clear (as a lower court had pointed out and as the House of Lords implied) that the rates which were approved as reasonable, in the absence of legislative restriction, involved any excessive return to the company; for the return was alleged to amount "at the utmost to 15 per cent," and the physical risk of loss to which the company's bridge was exposed was enormous.

[82] Railroad Commrs. of Iowa *v.* Illinois Central R. R., 20 I. C. C. 181 (1911). The complaint before the Commission asked for a reduction of the railroad passenger fares on a bridge across the Mississippi River. The income which the Illinois Central got from

opposite view of the question whether rates may exceed cost and still be reasonable. But the American law is clearly that rates above cost are unreasonable; that there is no constitutional obstacle to reducing them to cost; and that they should be reduced accordingly, whatever the value of the service may be.

It is clear that there can be no sense of the phrase value of the service, or reasonableness to the consumer, in which it is a criterion superior to, or coördinate with, cost of the service. If there were such a sense, it would follow, whatever the sense were, that the cost criterion would occasionally give way to it; and the cost criterion gives way to nothing. Rates may neither be fixed below cost when the value of the service is low, nor above cost when the value is high.

Is this as it should be? This raises the question, what is meant by value of the service, or reasonableness to the consumer? The phrases are much used and little defined. The word value, since it is spoken of in this connection as a measure of what purchasers should pay, is evidently not used in its ordinary sense: for we ordinarily mean by the value of a thing not a theory but a condition — the amount which people will and do pay for it. Neither, evidently, is value here used in the sense of cost: since it is offered precisely as a criterion distinct from cost. Neither does it mean the rate which will bring the producer the greatest aggregate profit (what the traffic will bear), nor the highest rate which some proportion or other of consumers will pay. There is little serious contention at present that rates should be kept up to such a point, and comparatively little need of a rule of law, or any other motive

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the bridge was a complicated bookkeeping question which the Commission did not answer categorically. After stating that "the net earnings of the bridge company are said to amount to about 20 per cent on the original cost of the structure," it intimated some doubt of the accounting processes by which that result was reached; but it did not in terms dispute it, nor fix on any lower percentage as more accurate. And it did distinctly hold that the "generous returns" did not constitute a reason for lowering the rate. This conclusion rested partly on the consideration that "bridges are and have been regarded as precarious properties" — a matter which goes to the cost of the service, and indicates that the real rate of return is less than the apparent one. But it also rested in part, expressly, on notions of reasonableness to the consumer, including the proposition that "testing the charge of 25 cents for passage over this bridge with the tolls exacted for passage over other bridges we find it not unreasonable." The bare cost basis would hardly have led the Commission to sustain the rate.

than self-interest, to keep them down to it. One critic has been led to the conclusion that "to say that the rate must not exceed what the service is reasonably worth . . . means nothing." [83] More exactly, perhaps, to say that the rate must not exceed what the service is reasonably worth, in any normal sense of worth, means nothing. Though the proposition means nothing if the words are taken in their ordinary sense, and nothing true in whatever sense they are taken, it may in some special sense of the words mean something false.

The sense which is given to the value of the service is not only special but various. The Interstate Commerce Commission has spoken of "value of the service, with its bundle of constituents," [84] without further definition; and again has used the phrase in the sense of the rates that "commodities and the industries that use them can well stand." [85] In another case, the thing the commission had chiefly in mind seems to have been the rates commonly charged for similar services.[86] In *Silk Association of America* v. *Pennsylvania Railroad Co.*,[87] the commission said, "Illustrative of the value of service is the percentage that the rate paid bears to the value of the article." A federal court has spoken of "the value of the service to the shipper" as "including the value of the goods and the profit he could make out of them by shipment." [88]

These various matters have one broad feature in common: they all go to public policy. That is, they affect the question what it is or may be thought desirable to charge for a service, as distinguished from the question what the service costs. No list can be drawn of all the considerations which may affect a tribunal's view of public policy in its bearing on rates. When value of service is spoken of, as it usually is, without attempt at definition,

[83] Robert L. Hale, "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," 18 COL. L. REV. 208, 210.

[84] Boileau *v.* P. & L. E. R. R., 22 I. C. C. 640, 652 (1912).

[85] Coke Producers' Assn. *v.* B. and O. R. R., 27 I. C. C. 125, 132 (1913).

[86] Railroad Commrs. of Iowa *v.* Illinois Central R. R., 20 I. C. C. 181, 186, and 189 (1911). *Cf. Re* Kent Water & Light Co., P. U. R. 1917 D, 394, 397, where the Ohio Public Utilities Commission said: "The value of the service . . . is reflected more or less by what such service is usually furnished for by other companies to other consumers under similar circumstances."

[87] 44 I. C. C. 578, 580 (1917).

[88] Interstate Commerce Com. *v.* Chicago Great Western Ry., 141 Fed. 1003, 1015 (1905).

there is no knowing whether the intended meaning is one or more of these enumerated considerations of policy, or other comparable ones, or all of them together; but something that may be classified as an idea of policy is probably always in mind. Perhaps the phrase has been oftenest used, though never defined, in the widest sense it can have (*i. e.*, the widest which excludes cost, and so is intelligible as a proposed criterion coördinate with cost) — the resultant of all the considerations other than cost (and discrimination) which ought as a matter of public policy to influence rates.

Value of the service, in any of these senses, not only is not, but should not be, and in some directions could not be, allowed to overrule cost. The most obvious objection to a value criterion is its indefiniteness. This results not merely from the fact that its formal definition is a matter of uncertainty and dispute. The several proposed definitions are each incapable of being applied to particular facts with any approach to certainty. What is the measure of what "commodities and the industries that use them can well stand"? How many rates elsewhere are to be collected for comparison, and is their simple average, a weighted average, or some other function to be selected? Is the rate per ton on every commodity to constitute the same fraction of its value, and if not, on what are variations from normal to be based? Just how much do all the considerations of public policy (independent of cost) make it desirable that the rate on coal from Scranton to New York should be? Value of the service cannot be made a primary criterion of rates without asking some questions of this sort; and if such questions are to be answered at all, they cannot fail to be answered in a great and shifting variety of ways. As Commissioner Meyer, speaking for the Interstate Commerce Commission, has said:

"As between . . . the cost of the service and the value of the service, the first is decidedly more capable of exact determination and mathematical expression than the latter. If, as some would have us believe, no measure has yet been discovered for ascertaining the cost of the service, what measure is there suggesting anything definite and tangible and sufficiently practical in its application to carry conviction which can be applied to the value of the service?" [89]

[89] Boileau *v.* P & L. E. R. R., 22 I. C. C. 640, 652 (1912). *Cf.* Duluth St. Ry. Co. *v.* R. R. Com. of Wis., 161 Wis. 245, 152 N. W. 887 (1915).

It has been pointed out that if any value criterion were set up as coördinate with the cost criterion, rates would sometimes have to be fixed below cost and sometimes above it. Consider first the idea of fixing rates below cost. Doubtless an economy is conceivable in which people would not produce goods and services because it was made financially worth their while, and in which capital would not be in private hands at all. But we are living in a society in which capital is in private hands, and one which gets its work done chiefly by the economic motive. Physicians and artists sometimes may, but the owners of capital as such certainly do not, do for us what does not promise to be worth their while. Now more capital is constantly needed for public utilities. The chance of its earning a great return, which is considerable in some kinds of business, is now comparatively negligible in this. The needed capital is nevertheless supplied — because a reasonable return is considered certain. If we are to continue to get this capital by voluntary induction from private sources, we must continue regularly to allow it a return.[90]

Doubtless the rates for some particular services might be fixed below cost; but, if capital were still to be attracted into public utilities, it would be necessary to allow such high rates at other points in the schedule as to make the aggregate return satisfac-

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[90] *Cf.* Robert H. Whitten, "Fair Value for Rate Purposes," 27 HARV. L. REV. 419, 422: "There is . . . sound reason why in the long run the public cannot pay less" than the normal cost of production. THORSTEIN VEBLEN, THE NATURE OF PEACE, 325, "So long as the price system rules, that is to say so long as industry is managed on investment for a profit, there is no escaping this necessity of adjusting the processes of industry to the requirements of a remunerative price."

In *Re* Portland Railway, Light & Power Co., P. U. R. 1918 B, 266, 274, 275, the Public Service Commission of Oregon, in granting an application for increased street-car fares, said: "A prime consideration in the investment of capital in enterprises designed to serve the public is the attitude of the public toward its servants, and this attitude is indicated chiefly by the actions of the rate-making authorities. . . . If any Public Service Commission should make a practice of enforcing rates which would not attract free capital, it is certain that the community would eventually lose more than it would gain."

Cf., also, L. R. A. 1915 A, 30, note.

Re Bronx Gas & Electric Co., P. U. R. 1918 D, 300, 331, 332 (New York Pub. Serv. Com., First Dist.): "Capital can be drawn to public utilities from private enterprises only by establishing an attractive relationship between the *certainty* of the return and the *percentage* of the return the utility is allowed to earn upon the money put into the project by investors. If the Commission cannot make a moderate return fairly certain, the percentage of return must be higher, else capital will be repelled."

tory. The favored consumers would be parasitic on other consumers; they could not long be upon the producer. The economics of such a course would be of a sort which has long been thoroughly discredited among economists, and is beginning to be among other people. If A wants a thing and is prepared to pay its cost, there is (at least if it is beneficial or harmless) no reasonable excuse for refusing to let him have it. It is perfectly inequitable to charge him more than its cost in order that a different thing may be furnished at less than cost to some one else.[91]

If a particular industry is unable to pay the cost of the service it desires, it should do what most people do with respect to what they cannot pay for; it should go without. Traffic which will not bear the cost of carrying it ought not to be carried. Its owners have no vested right to live at other people's expense, and that is what happens if they pay only part of the cost of their service while the utility collects the rest from others. The situation is not altered if the article carried, or otherwise served, is of low value. That a thing is cheap no more gives it a right to be carried free, or without fully paying its way, than an individual's poverty entitles him to be carried free.[92] If companies elsewhere are so fortunately situated that they can profitably furnish a given service at a lower rate than A, that is no reason for requiring A to furnish it at a loss. And as for public policy, the public has no such interest in this or that industry as to raise a policy in favor of putting its costs upon other industries; at least, it has no such obvious interest that commissions and courts may properly act on it.

There are as serious objections to fixing rates above cost. So far as a given service is competitive, that also cannot be done; if it were attempted, competitors would simply get all the business. And some public utilities have actual or potential competition.

[91] Pub. Serv. Com. *v.* Puget Sound International Ry. & Power Co., P. U. R. 1916 B, 81 (Pub. Serv. Com. of Wash.); *Re* United Traction Co., P. U. R. 1916 E, 249 (N. Y. Pub. Serv. Com., Second Dist.); Hughes, J., in Northern Pacific Railway *v.* North Dakota, 236 U. S. 585, 598 (1915).

[92] "It is urged by the State that the commodity in question is one of the lowest classes of freight. This may be assumed, and it may be a good reason for a lower rate than that charged for carrying articles of a different sort, but the mere grade of the commodity cannot be regarded as furnishing a sufficient ground for compelling the carrier to transport it for less than cost or without substantial reward." Northern Pacific Railway *v.* North Dakota, 236 U. S. 585, 597, 598 (1915).

Usually it is potential, and the costs of the potentially competing concern are not unlikely to be greater than those of the established one; but if rates are fixed seriously above the point at which the potential competitor could supply the demand, he will presently supply it. If the utility is free from competition, actual or potential, it can easily fix rates at the point of greatest net return, however far that may be above cost; if the law leaves it alone. But it seems clear that the law should, as it does, undertake to prevent that. It would be hard to find a presentable reason of policy for allowing the beneficiaries of a monopoly, natural or legal, more than a reasonable return on the value of their whole property, or more than a reasonable profit on any particular service. It is said that the utility should share in the prosperity of its customers; but it is not made clear why it should, and moreover it inevitably does,[93] through disposing of more of its product when its customers are prosperous. Should an industry pay a rate that yields more than a fair return, simply because it can pay such a rate and still do business? The proposition that it should leads logically to the old idea that a utility may properly charge "what the traffic will bear"; which means that it may absorb the entire profit of its customers, except just enough to keep them running. There may be good reason why the results of the enterprise or luck of the men in a particular business should go to others than themselves, to the state, for example; but why they should go to the monopolies which serve them it is hard to imagine.

Again, suppose companies elsewhere generally charge a rate which would give the particular company an inordinate profit. The most which one company can at all plausibly argue from the case of another is that it is entitled to parallel treatment. As the rates of the other companies are presumably based on their costs, and accordingly allow them only a reasonable profit, the particular company gets essentially parallel treatment if it also is allowed a reasonable profit. The fact that n is the rate which will yield a reasonable return to A company is no more reason for keeping the rates of B company, whose costs are lower, up to n, than for keeping the rates of C, whose costs are higher, down to n. Companies are concerned with rates only so far as they bear on

[93] The Interstate Commerce Commission points this out in Central Yellow Pine Assn. *v.* Illinois Central R. R., 10 I. C. C. 505, 536 (1905).

profits. Whether a company's net profits are more or less than is normal for similar companies has an immediate bearing on the question whether its profits, and consequently its rates, are reasonable; but a comparison of the rates themselves is significant only indirectly.

As to the value of the article, of which much is made in discussions of the value of the service, it is hard to see why the shippers of valuable articles are not as well entitled as the shippers of cheaper ones to be served at cost, including risk and a reasonable profit. There is no public policy against owning or shipping valuable articles, and consequently no reason for imposing a tax on their circulation. Even if and when it is well to impose a tax on the circulation of some things, as being harmful or luxurious, the tax should be collected by the state and not by utility companies.

To charge something in addition to cost for the transportation of a commodity has the same sort of effect as a customs tariff between the places affected. That interstate customs tariffs are forbidden by the Constitution is not the worst that can be said of them. They would prevent people in one part of the country from getting the maximum benefit from the low cost of production of particular things in other parts of the country. They would injure the consuming region by reducing consumption (and consequently the production of other things for purposes of exchange), and the producing region by reducing production (and consequently the consumption of other things got by exchange). A transportation charge which exceeds cost acts in the same way.

In practice it would nearly always be impossible to fix rates below cost, whatever legal theory might have to say about it; while it would be very easy, if the law permitted, to fix them above cost in every case in which competition would not be stirred up by doing so. The net result of adopting the two halves of the value-of-the-service theory would therefore be a serious increase in public utility rates as a whole.

It appears, then, that the various circumstances other than cost which are sometimes referred to, under the name of value of the service, as bearing on rates — such as the prosperity or de-

pression of a class of patrons; the cheapness or costliness, the necessary or luxurious character of an article served; the fact that rates elsewhere are high or low — not only do not, but should not and in some directions could not operate to overrule cost or reasonableness to the producer. There must always be a substantial return to the utility, if that is possible; and this could not be so if rates were limited at the upper end by any consideration of value of the service or reasonableness to the consumer. The return to the utility must never be enormous, and this could not be so if rates were limited at the lower end by any such consideration. The sole primary requirement is that the return to the utility shall be reasonable; in other words, the maximum and minimum limits of rates are fixed exclusively by cost.

It does not follow that the circumstances referred to as value of the service have no effect on rates. They readily may, there are reasons why they should, and some of them undoubtedly do, operate to fix rates at a higher or lower point within the range of cost. There is no uniform rule that a reasonable return consists of a given percentage on the fair value of the property employed. On the contrary, the percentage of return upon the fair value of the property which it is reasonable for a utility to earn is agreed to be a variable percentage. Between the lowest return that is substantial and the highest that is not inordinate, there is a belt, more or less broad, of returns which are reasonable in some circumstances and not in others. In accordance with what does the return which it is reasonable for a utility to earn vary? It cannot vary in accordance with the cost of the service. The cost of the service consists of the costs of operation, maintenance, and insurance, depreciation, and the very item we are now considering — a reasonable percentage on the value of the property employed. The percentage of return which is reasonable cannot depend upon itself, or upon the value of the property to which the percentage is to be applied, or upon the size of any of the items which must be covered before a return begins to accrue — maintenance, operating expenses, insurance, and depreciation — unless it be, in some cases, operating expenses.[94] Since it cannot normally

[94] It is sometimes said that the efficiency of the company should affect the rate of return allowed; Taylor *v.* Northwest Light & Water Co., P. U. R. 1916 A, 372, 389,

depend upon the elements that go to make up cost, it cannot depend upon cost. It must therefore depend on something other than cost. That is to say that it must depend upon the value of the service, if not in one or more of the specific senses which have been suggested for that phrase, then in the broad sense of all the circumstances other than cost (and discrimination) which strike the court as affecting the question what rate is proper.

Since the primary requirement is that rates shall equal cost, the value of the service can take effect only so far as cost is in doubt. But cost is always in doubt. Even the cost of a company's whole product is by no means free from doubt. The mere amount of the property employed is certain, and the cost of maintenance and operation is tolerably certain; but the value of the property and its rate of depreciation are matters of opinion, and the proper rate of return is eminently a matter of opinion. Ideas of public policy exert their chief influence in the determination of what constitutes a reasonable rate of return; but judges could not if they would, and there is no reason why they should, altogether exclude the influence of such ideas in deciding on the fair value of the property and its rate of depreciation. In the case of a particular service, the doubtful element in cost is far larger still. When, as in the case of a carrier, a company is performing a variety of services, it is clear and familiar that there is no means of determining neatly the share of the value of the whole property, or of depreciation, or of the costs of operation and maintenance, which ought to be attributed to each. The question exactly what a particular service costs is therefore "one of almost insuperable difficulty." [95]

It is unquestioned that the profit which a utility may earn on its entire business is variable; and observations to that effect have frequently been coupled with references to the interest of consumers. The United States Supreme Court has said:

"If the answer had not alleged, in substance, that the tolls prescribed . . . were wholly inadequate for keeping the road in proper repair and

390 (Idaho Pub. Util. Com.); Duluth St. Ry. Co. *v.* R. R. Com., 161 Wis. 245, 152 N. W., 887 (1915); P. U. R. 1915 D, 192, 206. There is little objection to putting the matter in this way, and considering that it involves varying the return (inversely) with the cost. But, if cost is defined as reasonable or normal cost, the return above cost is not made to fluctuate when the efficient company is allowed a greater profit than the inefficient one.

[95] Central Yellow Pine Assn. *v.* Illinois Central R. R., 10 I. C. C. 505, 538 (1905).

for earning dividends, we could not say that the act was unconstitutional merely because the company (as was alleged and as the demurrer admitted) could not earn more than four per cent on its capital stock. It cannot be said that a corporation is entitled, as of right, and without reference to the interests of the public, to realize a given per cent upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored." [96]

But the statement of variability is most commonly made, as one would expect, with reference to the return on particular services. In *Northern Pacific Railway* v. *North Dakota*, the very case in which it was laid down that the value of a service could not be made an excuse for fixing rates below cost, the United States Supreme Court said:

"The legislature, undoubtedly, has a wide range of discretion in the exercise of the power to prescribe reasonable charges, and it is not bound to fix uniform rates for all commodities or to secure the same percentage of profit on every sort of business. There are many factors to be considered — differences in the articles transported, the care required, the risk assumed, the value of the service, and it is obviously important that there should be reasonable adjustments and classifications. . . . The court . . . is not called upon to concern itself with mere details of a schedule; or to review a particular tariff . . . which yields substantial compensation for the services it embraces, when the profitableness of the intrastate business as a whole is not involved." [97]

And the actual effect of the value of the service on rates is, naturally, most evident in cases dealing with classification, or other-

[96] Covington Turnpike Co. *v.* Sandford, 164 U. S. 578, 596 (1896). *Cf.* Southern Indiana Ry. Co. *v.* R. R. Com., 172 Ind. 113, 128, 87 N. E. 966, 971 (1909). "What that profit shall be — whether ten, six, two, or any other per cent — must be determined from the facts of each particular case, taking into account, as against the cost and earning capacity of the railroad, the value of the service to the shipper, and the amount he can reasonably afford to pay. In short, as the charge approaches oppression to the shipper, it should in the same degree approach the point of minimum profit to the carrier."

[97] 236 U. S. 585, 598, 599 (1915). Similarly, in Norfolk & Western Railway *v.* West Virginia, 236 U. S. 605, 609 (1915), the court said: "The state is under no obligation to secure the same rate of return from each of the two principal departments of business, passenger and freight." *Cf.* Bogart *v.* Wis. Tel. Co., P. U. R. 1916 C, 1020, 1053, 1054 (Wis. R. R. Com.).

wise passing on particular rates. As the Interstate Commerce Commission said in 1912,

"In all classification consideration must be given to what may be termed public policy, the advantage to the community of having some kinds of freight carried at a less rate than other kinds." [98]

For example, the Interstate Commerce Commission has treated the prosperity or depression of the business affected by a particular rate as bearing on the question what the rate should be, when there has been no question of going above or below the limits of cost. The complainant's prosperity was treated in *Hitchman Coal & Coke Co.* v. *Baltimore & Ohio Railroad* [99] as pointing more or less to the conclusion, which the commission reached, that the rates complained of were not too high; and in *Cattle Raisers' Association of Texas* v. *M. K. and T. Railway* [100] the depression of the complainants' business was treated as having some tendency, though a slight one, to justify the commission's action in lowering rates.[101] But it can hardly be said to be established law that prosperity or the lack of it on the part of consumers is entitled to any weight at all.

On the other hand, it is entirely settled that the value of an article served counts in fixing the rate. In 1917, in dismissing a

[98] *In re* Advances in Coal Rates, 22 I. C. C. 604, 623 (1912). The *dictum* in this case that the Norfolk & Western did not prove itself entitled to an advance by the mere showing that existing rates did not cover the cost of the service is overruled, if it was ever law — which is very doubtful — by Northern Pacific Railway *v.* North Dakota, 236 U. S. 585 (1915).

In Coke Producers' Assn. *v.* B. & O. R. R., 27 I. C. C. 125, 132, 140 (1913), rates were lowered on the ground, among others, of public policy in favor of the dissemination of an article. The Public Service Commission of West Virginia took similar action in Greer *v.* B. & O. R. R. Co., P. U. R. 1916 D, 286, 301. *Cf.* R. R. Passenger Rate Case, P. U. R. 1915 B, 362, 386. (Mass. Pub. Serv. Com.), and Bogart *v.* Wis. Tel. Co., P. U. R. 1916 C, 1020, 1053, 1054, on propriety of favoring some classes of traffic.

[99] 16 I. C. C. 512 (1909).

[100] 11 I. C. C. 296, 348 (1905).

[101] In Central Yellow Pine Assn. *v.* Illinois Central R. R. Co., 10 I. C. C. 505 (1905); and Tift *v.* Southern Railway, 10 I. C. C. 548 (1905); the Interstate Commerce Commission, in holding that the prosperity of a business cannot excuse the imposition of a rate which exceeds cost, used language which, taken literally, would indicate that the prosperity of a business served has nothing at all to do with the propriety of a rate. But the Commission may be supposed to have had in mind only the question with which it was dealing, *viz.*, the question of allowing a rate to exceed cost. The question of fixing a rate higher or lower within the range of cost is distinct.

complaint against a carrier's rate on raw silk, the Interstate Commerce Commission said:

"The increase in the hazard is not the only fact to be considered in prescribing rates for the transportation of highly valued commodities. The Supreme Court in *N. P. Ry.* v. *North Dakota*, 236 U. S. 585, 599, in giving some of the many factors which should be considered in making rates, names 'the risk assumed' and also 'the value of the service.' This Commission has throughout its history given consideration to the value of a commodity when determining what is a reasonable rate thereon. Illustrative of the value of service is the percentage that the rate paid bears to the value of the article. . . . Silk is one of the commodities of the highest value in proportion to the ratio which the charges bear to the value of the commodity." [102]

Weight is constantly being given, in passing on rates, to comparisons with rates at other points where conditions are similar.[103]

In passing on the rate for a particular service, tribunals not infrequently refrain altogether from guessing what the cost of the service may be. The difficulty or impossibility of fixing exactly the cost of a particular service, and the special regard which is

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[102] Silk Assn. of America *v.* Penn. R. R., 44 I. C. C. 578, 580, 581 (1917). Similarly, in 1916, in a case involving advances on live stock, the commission adjudged that "rates for the transportation of any of the animals named . . . which are increased . . . by more than 2 per cent for each 50 per cent . . . of additional value are . . . unreasonable." National Society of Record Assns. *v.* Aberdeen & Rockfish R. R. Co., 40 I. C. C. 347, 355 (1916). The same principle was applied in Iowa R. R. Commrs. *v.* A. T. & S. F. Ry. Co., 36 I. C. C. 79, 85 (1915). *Cf.* Coke Producers Assn. *v.* B. & O. R. R., 27 I. C. C. 125 (1913); Ford Co. *v.* Michigan Central R. R., 19 I. C. C. 507, 509 (1910); Union Tanning Co. *v.* Southern Ry., 26 I. C. C. 159, 163 (1913).

State tribunals have recognized the same principle. *Cf., e. g.*, Copeland Ore Co. *v.* M. T. Ry. Co., P. U. R. 1917 F, 182, 195 (Colo. Pub. Util. Com.).

[103] *E. g.*, Freight Bureau of Cincinnati *v.* Cincinnati, N. O. & T. P. Ry., 6 I. C. C. 195 (1894); Oregon & Washington Lumber Mfrs. Assn. *v.* S. P. Co., 21 I. C. C. 389, 392, 393 (1911); Boileau *v.* P. & L. E. R. R. Co., 22 I. C. C. 640 (1912); Marian Coal Co. *v.* D. L. & W. R. R., 24 I. C. C. 140, 142 (1912). *Cf.* Interstate Commerce Com. *v.* Louisville & Nashville Ry., 118 Fed. 613 (1902). Comparisons with other rates were used in support of increases in *Re* East St. Louis Light & Power Co., P. U. R. 1918 B, 320 (Ill. Pub. Util. Com.); Railroad Passenger Rate Case, P. U. R. 1915 B, 362, 392 (Mass. Pub. Serv. Com.); and in support of reductions or refusals to increase, in State *ex rel.* Watts Engineering Co. *v.* Pub. Serv. Com., 269 Mo. 525, 191 S. W. 412, P. U. R. 1917 C, 581, 591; Pub. Serv. Gas Co. *v.* Board of Pub. Util. Commrs., 84 N. J. L. 463, 474, 475, 87 Atl. 651 (1913); Hocking Valley R. R. Co. *v.* Pub. Util. Com. of Ohio, 92 Ohio St. 362, 110 N. E. 952 (1915), P. U. R. 1916 B, 406; *Re* Kans. City Elec. Lt. Co., P. U. R. 1917 C, 728, 790 (Mo. Pub. Serv. Com.); *Re* Kent Water & Light Co., P. U. R. 1917 D, 394, 397 (Ohio Pub. Util.Com.).

consequently shown for value in fixing the rates on particular services, have sometimes led to the assertion — notably by the Interstate Commerce Commission [104] — that very different considerations must govern the fixing of particular rates from those that apply to an entire schedule; that the cost of a particular service, being unascertainable, can have little to do with the propriety of a particular rate, and that particular rates must therefore be governed largely by value of service. This assertion is true within limits, but there are two observations to be made upon it which greatly qualify its apparent meaning. In the first place, it implies that the value of a service is ascertainable, if not quite definitely, at least more definitely than its cost. But if one recalls the variety of elusive ideas which go under the name of value of the service it is evident that this is not so. On the contrary, as the Interstate Commerce Commission itself has pointed out, "the cost of the service is ascertainable with much more precision and capable of more tangible expression than the value of the service." [105] In the second place, the proposition more or less suggests that, in respect to particular rates, the criterion of value is deliberately preferred and preferable to the criterion of cost; in other words, it overrules cost. That is far from true. To allow value to influence rates within the range where cost is doubtful is not to prefer value to cost; it is simply to prefer value to nothing. The question which is to prevail can arise only when both are known; so far as either is unknown there is no conflict. And, as has been pointed out, when there is a conflict it is cost and not value that prevails. The Supreme Court has held that coal rates [106] and passenger rates [107] which are below cost must be raised, and that lumber rates which exceed cost must be lowered.[108] From the fact that costs are less accurately determinable in the case of a particular service than in that of an entire business, it follows that the range of what may or might be found to be cost is a broader range in the case of the particular service; and this is the

[104] Central Yellow Pine Assn. *v.* Ill. Central R. R. Co., 10 I. C. C. 505, 539, 540 (1905).

[105] Boileau *v.* P. & L. E. R. R., 22 I. C. C. 640, 652 (1912).

[106] Northern Pacific Railway *v.* North Dakota, 236 U. S. 585 (1915), (note 53, *supra*).

[107] Norfolk & Western Ry. Co. *v.* Conley, 236 U. S. 605 (1915), (note 56, *supra*).

[108] Southern Railway *v.* Tift, 206 U. S. 428 (1907); Illinois Central R. R. *v.* Interstate Commerce Com., 206 U. S. 441 (1907) discussed above.

truth in the statement that cost has less, and value more, to do with rates for particular services than with entire schedules.

The proposition that the value of the service does not count at all in fixing rates is evidently only less erroneous than the proposition that it is of coördinate importance with cost. To say that nothing counts but cost is to say that courts require a rate of profit which is absolutely uniform on a fair value which is definitely ascertainable; whereas the fact is that the fair value of an entire property is matter of opinion, the proportion of it which should be attributed to a particular service is matter of guess, and various rates of profit are thought proper in various cases. The value of the service, in the sense of some of the considerations of public policy which affect the question, what the rate ought to be, is an actual rate-making criterion, although subordinate to cost.

And it seems highly desirable that this subordinate effect should be allowed to some of these considerations. The argument rests in part on the assumption that a general diffusion of things is desirable. As time goes on, more kinds of things are used by more people in more places. This constitutes progress in the sense that it is the direction in which we are moving, and it is generally assumed to be progress in the sense of being desirable. And attention to the value-of-the-service sort of consideration in the making of rates encourages this diffusion.

Take the prosperous or depressed condition of an industry which a public utility serves. To say that an industry is prosperous means that it is disposing of an unusually large amount of its product, or selling it at an unusually high price, or both. From the fact of large sales it follows that the dissemination of the product does not, relatively to other commodities, need encouragement, and is not likely to cease or become insignificant if it is made necessary to charge a higher price. From the large margin of profit it follows that a higher rate to the public utility might not make it necessary or feasible to charge a higher price for the commodity. From both circumstances or either it appears that the use of the article will not be disastrously interfered with by a higher charge on the part of the public utility. The reverse of all this is true in the case of a depressed industry. It is, by hypothesis, marketing unusually little of its product, or selling it on an unusually narrow

margin, or both. The use of the article, already subnormal, will be further restricted if the price of it is raised; and the small present profit makes it probable that the price will have to be raised if the public utility's rate is raised. All this would constitute no excuse for charging the prosperous industry a rate which would yield the utility more than a reasonable return, to the enrichment of the utility or its other consumers, or for charging the depressed industry a rate which would not cover cost, and throwing the resulting burden on other consumers. But it does constitute a reason for giving the benefit of the doubt, in valuation of plant, apportionment of costs, and determination of what return is reasonable, to the utility in the case of the prosperous customer and to the purchaser in the case of the depressed one. A similar argument can be made for considering the value of the article served, and allowing a more generous return, within the limits of cost, from the more valuable than from the less valuable article. The dearer a commodity is, the smaller in general is the fraction of its cost which consists of freight rate or other public-utility charge. But for the fact that freight rates are graduated more or less in accordance with the value of the article, the rate would be a smaller fraction of the article's whole cost in the case of the dearer in exactly the proportion that it is dearer. A cent a pound in a freight rate may make a difference of 1 per cent in the price of a dearer article and of 50 per cent in the price of a cheaper one. It follows that a higher public-utility charge does not so greatly interfere with the use of the dearer commodity as of the cheaper.

So far as high-cost commodities are in the nature of luxuries, this proposition doubtless fails in some degree; since it is in general easier to check the demand for a luxury than for a necessity. But this, as an argument against high rates on luxuries, is offset by the consideration that the distribution of luxuries, while important, is less important than the distribution of necessities. Their use may be the more checked by a higher rate, but the checking of their use is the less unfortunate. On the whole, therefore, the benefit of the doubt concerning costs and returns may well be given to the company as against the luxury, and to the necessity as against the company. And with luxuries, or beyond them, should be classed for this purpose articles the consumption of which is

regarded as an evil; and with necessities, articles the consumption of which is thought specially desirable.

The interest of manufacturers, dealers, and employees furnishes an argument which parallels, in large part, that based on the interest of consumers. It is obviously to the interest of the people engaged in an industry that it survive. So far as anything tends to kill it, to them it is, in that proportion, an evil. And a prosperous business is obviously less likely to be ruined by increasing its costs than a depressed one.

The case is less strong for making anything turn on a mere comparison of rates in different localities; yet there does appear to be a certain advantage, other things being equal, in uniformity. People in one locality tend to be placed at a disadvantage in competition with people in another if they have to pay higher rates to public utilities. Moreover, the general prevalence of a given rate, since it tends to show what costs are and rates should be in many places, is some evidence, though slight and indirect, of what they are and should be in a particular place. Though the fact that rates are higher or lower elsewhere is no reason for fixing them above or below cost anywhere, it is some reason for taking a broader or narrower view of cost.

In summary: It is frequently said, by eminent courts, commissions, and text-writers, that the value of a service is entitled to quite as much weight as the cost of the service in the fixing of public-service rates. The decisions do not bear out, but contradict, such statements. The decisions establish that the value of the service — which means substantially public policy — is not a criterion either superior to or coördinate with the cost of the service. This is entirely sound and largely inevitable. But the uncertainties of cost (though narrower than the uncertainties of value) offer room for value to operate as a subordinate criterion, by fixing rates higher or lower within the range of cost; and some aspects of value do, and quite as many should, operate in that way.

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